

UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF NORTH CAROLINA  
DURHAM DIVISION

ENTERED

SEP 02 2003

U.S. BANKRUPTCY COURT  
MDNC - MEL

IN RE: )  
 )  
Magna Corporation, ) Case No. 01-80763C-7D  
 )  
Debtor. )  
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 )  
Safeco Insurance Company of )  
America and General Insurance )  
Company of America, )  
 )  
Movants, )  
 )  
v. ) Contested Matter  
 )  
William L. Yaeger, Trustee )  
for Magna Corporation, and )  
Fireman's Fund Insurance )  
Company, )  
 )  
Respondents. )  
 )

MEMORANDUM OPINION

This case came before the court on July 17, 2003, for hearing upon a motion by William L. Yaeger, the Chapter 7 Trustee in this case, for approval of a proposed settlement with Safeco Insurance Company of America and General Insurance Company of America. Sara A. Conti appeared on behalf of the Trustee. Mark A. Cullen, appearing on behalf of Fireman's Fund Insurance Company, and David C. Smith, appearing on behalf of CS Enterprises, Inc., opposed the approval of the proposed settlement. Having considered the evidence offered by the parties, the memoranda and briefs submitted by the parties and the arguments of counsel, the court finds and concludes

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as follows:

#### MATTER BEFORE THE COURT

The proposed settlement pertains to a contested matter involving the Trustee and Safeco Insurance Company of America and General Insurance Company of America (hereinafter referred to collectively as "Safeco"). The subject of the contested matter is a certificate of deposit in the original amount of \$1,987,268.04. The certificate was purchased by the Debtor at Central Carolina Bank ("CCB") on June 20, 2000, and was held in the Debtor's name at CCB when this case was filed on March 19, 2001. The controversy involved in the contested matter is whether the certificate of deposit is property of the bankruptcy estate in this case or whether, as contended by Safeco, the certificate of deposit is subject to either an express or constructive trust and therefore not property of the estate pursuant to § 541(d) of the Bankruptcy Code. The certificate of deposit has continued to earn interest and the value of the certificate of deposit was \$2,226,074.12 as of July 17, 2003. Under the proposed settlement, the Trustee would receive \$500,000.00 from the proceeds of the certificate of deposit and the remainder of the funds represented by the certificate of deposit would be paid to Safeco for application to its claim in this case.

#### FACTUAL BACKGROUND

Prior to filing this case, Magna was engaged in business as an employee leasing services company. Magna's business included the

procurement of workers compensation and employer liability insurance for the employees that it provided to its clients. Magna obtained two such policies from Safeco, the first in January of 1999 and the second in January of 2000. These policies required Magna to reimburse Safeco for certain deductible amounts and claims adjustment expenses related to the policies. In order to obtain the policies, Magna agreed to create and fund a trust which was to provide Safeco with monetary protection in the event Magna defaulted in paying its obligations under the policies. A trust agreement was executed by representatives of Magna, Safeco and CCB which identified Magna as grantor, Safeco as beneficiary and CCB as trustee. The trust agreement is dated "as of" January 14, 1999, and provides that Magna is to establish a trust account at CCB and that the principal deposited in the trust account shall be distributed to the Beneficiary or the Grantor "at such time and in such amounts as the Beneficiary shall request in writing." The trust agreement refers to account number 809431625 at CCB (hereinafter referred to as account number 1625). This is the account that Safeco contends is the trust account referred to in the trust agreement.

Account number 1625 was opened by Magna at CCB pursuant to a resolution that is dated March 2, 1999. Although account number 1625 is referred to in the trust agreement, there is no reference in the resolution to the account being a trust account nor is there any reference to Safeco. Under the resolution, which was

prepared on a CCB form, the account is designated as a "Corporation" type of account and is a savings account in the name of "Magna Corp". The resolution authorizes CCB to permit withdrawals from the account pursuant to checks, drafts or other orders for the payment of money drawn in Magna's name and signed by the Magna officers listed in the resolution. Nothing in the resolution requires the approval or authorization of Safeco in order for funds to be withdrawn from the account by Magna.

After opening account number 1625, Magna began depositing funds into the account, apparently commencing on March 2, 1999, when a deposit of \$250,769.24 was made. Thereafter, additional deposits were made into the account by Magna on various dates between March 2, 1999, and approximately September of 1999. During this period Magna also made withdrawals from the account that were not paid to Safeco.

After account number 1625 was opened, Magna notified Safeco that the account had been opened and represented to Safeco and CCB that it was a trust account for the benefit of Safeco. On various occasions after the account was opened, representatives of Safeco communicated with CCB in order to verify the amount on deposit in account number 1625 and were provided with the account balance by CCB on those occasions.

In June of 2000, Magna was notified by Safeco that Magna had failed to meet certain of its obligations to Safeco. At that point

account number 1625 had a balance of \$1,987,268.04. On June 20, 2000, Magna transferred the entire \$1,987,268.04 into a certificate of deposit and closed account number 1625. The certificate of deposit was issued to Magna as owner and, as was the case with account number 1625, contained no reference to Safeco or to the certificate of deposit being subject to a trust. However, the certificate of deposit was left in the possession of CCB where it was located when the Chapter 7 case was filed.

On June 21, 2000, unaware that the account had been closed, a representative of Safeco made demand upon CCB for the funds believed to be on deposit in account number 1625. When no funds were paid to Safeco, Safeco filed suit against Magna and CCB on July 13, 2000, in the United States District Court for the Middle District of North Carolina. On July 21, 2000, an injunction was entered in the district court restraining CCB from distributing any of the funds on deposit in the certificate of deposit pending the resolution of the lawsuit. The certificate of deposit was still being held by CCB when Magna filed this Chapter 7 bankruptcy case on March 19, 2001. Safeco then initiated a contested matter in the bankruptcy court to establish its claim to the certificate of deposit. The motion now before the court seeking approval of the proposed settlement of the contested matter was filed after extensive discovery by Safeco, the Trustee and Fireman's Fund.

## STANDARD FOR APPROVAL OF SETTLEMENT

This matter is before the court pursuant to Rule 9019(a) of the Federal Rules of Bankruptcy Procedure which provides that "on motion by the trustee and after a hearing on notice to creditors . . . the court may approve a compromise or settlement." In deciding whether a settlement proposed by a bankruptcy trustee should be approved, the bankruptcy court should make an informed, independent judgment as to whether a settlement is fair and equitable and in the best interests of the estate. See Protective Committee for Independent Stockholders Of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424, 88 S.Ct. 1157, 1163, 20 L.Ed.2d 425 (1968); Matter of Energy Cooperative, Inc., 886 F.2d 921 (7th Cir. 1989). In making this determination, the court is not required to turn the settlement hearing into a trial or a rehearsal of a trial on the merits, nor is the court required to reach any dispositive conclusions regarding any unsettled legal issues in the case. See In re Blair, 538 F.2d 849, 851 (9th Cir. 1976) ("mini trial" on the merits not required). Instead, the court may limit the proceedings and its consideration to whatever is necessary in order for the court to determine whether the settlement is in the best interest of the estate. See Flinn v. FMC Corp., 528 F.2d 1169, 1172-73 (4th Cir. 1975). It is the court's responsibility to "canvass the issues and see whether the settlement 'falls below the lowest point in the range of reasonableness.'" See In re Drexel Burnham Lambert Group, Inc., 134

B.R. 493, 497-98 (Bankr. S.D.N.Y. 1991) (quoting from In re W.T. Grant, Co., 699 F.2d 599, 608 (2d Cir. 1983)). Central to this determination is a comparison of the terms of the settlement with the probable outcome and cost if the litigation or matter in dispute is not settled. The factors which should be considered by the court in determining whether the settlement is within the range of reasonableness include (1) the probability of success compared to the benefits offered by the settlement, (2) the complexity of the litigation or matter in dispute, (3) the expense, inconvenience and delay likely to result if the settlement is not approved, (4) the stage of the proceedings, including the extent of the discovery that has been conducted, (5) the experience and ability of counsel who represent the trustee, and (6) the extent to which the settlement is the product of arm's length negotiations and bargaining. See Matter of Energy Cooperative, Inc., 886 F.2d 921, 927 (7th Cir. 1989); In re Drexel Burnham Lambert Group, Inc., 134 B.R. at 497.

#### ANALYSIS

Having considered the foregoing factors, the court is satisfied that the proposed settlement with Safeco is above the lowest point in the range of reasonableness, and is fair and reasonable and in the best interest of the estate. In reaching this conclusion, the court observes that the contested matter involving the Trustee and Safeco has reached the stage at which the facts and legal issues have been developed sufficiently for the court to make a reasonably



informed assessment of the probable outcome of a trial. As the record will reflect, the parties have engaged in extensive discovery that included depositions from many of the witnesses who would be called to testify at trial as well as discovery of the contractual documents, pertinent correspondence and other relevant documents. At the conclusion of discovery, both the Trustee and Safeco filed motions for summary judgment and supporting briefs which discussed exhaustively the contentions of the parties regarding the evidence developed during discovery and the legal issues involved in the contested matter. In addition to this information, the court also had the benefit of briefs from the Trustee, Safeco and Fireman's Fund that were filed in support of and in opposition to the motion for approval of the settlement. The result is a record that is unusually informative regarding the evidence and legal issues that likely would be presented at trial.

The parties agree that § 541(d) of the Bankruptcy Code is critical to the outcome of the dispute. Under this provision, property in which the debtor holds only legal title and not an equitable interest becomes property of the bankruptcy estate "only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold." It is well settled that under § 541(d) of the Bankruptcy Code the beneficiaries of a valid trust are entitled to the trust property to the exclusion of creditors or other

claimants. See In re Marrs-Winn Co., Inc., 103 F.3d 584, 589 (7th Cir. 1996) ("trust proceeds can only be distributed to trust beneficiaries, and not to the creditors of the bankruptcy estate"); American Service Co. v. Henderson, 120 F.2d 525, 530 (4th Cir. 1941) ("where the debtor had been in the possession of trust property, the bankruptcy or reorganization trustee holds such property subject to the outstanding interest of the beneficiaries"); see also COLLIER ON BANKRUPTCY ¶ 541.11[5] (15th ed. rev. 2003). The outcome of the contested matter thus hinges on whether the funds that were deposited into account number 1625 were subject to a valid trust. If the funds are subject to a valid express or constructive trust, the Trustee loses and Safeco gets all of the money since its claim under the policies greatly exceeds the current value of the certificate of deposit.<sup>1</sup>

Based upon a choice of law provision contained in the trust agreement that specifies the law of the State of Washington, the parties seem to agree that Washington law is controlling on the issue of whether a valid trust was created. Washington law regarding the requirements for the creation of a trust is rather liberal, requiring only a showing that (1) the settlor expressed an intent to create a trust, (2) a fiduciary relationship existed with

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<sup>1</sup>Safeco's proof of claim is in the amount of \$45,421,447.00, consisting of \$32,724,560.00 which was non-contingent and liquidated when the claim was filed and \$12,696,887.00 of estimated future liability.

respect to the property, and (3) a trustee holds the property for the benefit of a third party. See Goodman v. Goodman, 907 P.2d 290, 293 (Wash. 1995); In re Lutz, 873 P.2d 566, 571 (Wash. 1994). Although neither party has been able to cite a Washington case involving facts even remotely similar to those involved in this case, the probability of success regarding these requirements being shown in this case weighs considerably in favor of Safeco.

It appears that Safeco will be able to offer strong, perhaps irrefutable, evidence that Magna intended to create a trust in favor of Safeco. In that regard, it is undisputed that Magna executed the trust agreement providing for Magna to establish a trust account at CCB for the benefit of Safeco. While it is less clear that Safeco can carry the burden of showing that a fiduciary relationship existed with respect to account number 1625 and the certificate of deposit and that CCB held the funds that went into account number 1625 and then into the certificate of deposit for the benefit of Safeco, the probability of success on these issues, as well, weighs decidedly in favor of Safeco. Because of the circumstances surrounding the opening of account number 1625, including the fact that the resolution does not refer to the account being a trust account or mention Safeco and the fact that Magna had access to the funds that were deposited into the account, disputed issues arise as to whether Magna intended that account number 1625 was to be a trust account for the benefit of Safeco and hence whether a fiduciary

relationship existed with respect to the funds in the account and whether such funds were held by CCB as trustee rather than merely as a depository bank for a corporate savings or checking account. While there may be testimony from some bank employees that bank procedures for a trust account were not followed, the discovery in this case indicates that the Magna employees who opened the account and handled the deposit and withdrawal of funds from the account, as well as the CCB employee who signed the trust agreement, likely will testify that account number 1625 is the account that was opened pursuant to the trust agreement, and the Magna employees likely will also testify that the funds that were deposited in account number 1625 were placed there for the benefit of Safeco. Moreover, it is undisputed that after the account was opened, employees of Magna represented to Safeco that account number 1625 was the trust account called for under the trust agreement and that when Safeco thereafter called CCB to check on the account, CCB employees were permitted by Magna and CCB to supply information directly to Safeco regarding the account such as the account balance. It thus appears that Safeco will be able to make a strong showing that the funds in account number 1625 were subject to an express trust in favor of Safeco.

Of course, the funds did not remain in account number 1625. On June 20, 2000, Magna caused the funds to be transferred into a certificate of deposit, where they remained until this bankruptcy

case was filed. Safeco maintains that the funds remained trust funds after they were transferred into the certificate of deposit, arguing that the certificate was left in the possession of CCB and held in trust by CCB. Safeco finds support for this argument from the testimony of certain Magna employees that the transfer was made simply to obtain a higher interest rate for Safeco and not to deprive Safeco of the funds. However, the timing and circumstances surrounding the transfer of the funds raise a question as to the actual motive of the Magna employees in making the transfer. But, even if Magna's motive was to spirit the funds away from Safeco, Safeco argues that the funds are readily traceable from the trust account to the certificate of deposit and that the funds became subject to a constructive trust in favor of Safeco because, in transferring the funds out of the trust account, Magna exercised improper and wrongful control over proceeds that were being held in trust for Safeco. These arguments, of course, are disputed by the Trustee.

In evaluating the constructive trust arguments, resort again must be had to state law. See In re Dameron, 155 F.3d 718, 722 (4th Cir. 1998). The choice of law clause in the trust agreement is not involved with respect to the constructive trust issue because the existence of a constructive trust does not depend upon or derive from the trust agreement. Instead, whether a constructive trust should be imposed depends upon the particular circumstances

surrounding a transaction and the conduct of the parties involved in the transaction. Since all transactions and conduct at issue in this case occurred in North Carolina, the law of North Carolina is controlling in determining whether a constructive trust is available for the benefit of Safeco.

A review of the North Carolina cases reflects that the standards for the imposition of a constructive trust are stated in broad, general terms and that the cases are very fact specific and result driven. Although some type of misconduct or the violation of a fiduciary duty by the defendant is required, actual fraud is not required in order for a constructive trust to be imposed. See Roper v. Edwards, 323 N.C. 461, 465, 373 S.E.2d 423, 425 (1988); Leatherman v. Leatherman, 297 N.C. 618, 621-22, 256 S.E.2d 793, 795-96 (1979). "A constructive trust is merely a procedural device by which a court of equity may rectify certain wrongs." Weatherford v. Keenan, 128 N.C. App. 178, 179, 493 S.E.2d 812, 813 (1997) (quoting from New Amsterdam Cas. Co. v. Waller, 301 F.2d 839 (4th Cir. 1962)). "When a court impresses a constructive trust upon property for the benefit of a claimant, it exercises its equitable powers to fashion remedies." Id. Equitable power may be so utilized when specific restitution in equity is appropriate on the particular facts before the court. Id. The imposition of a constructive trust is appropriate under North Carolina law to prevent the unjust enrichment of the holder of the legal title to

property that was acquired through fraud or a breach of duty that makes it inequitable for the holder to retain the property against the claim of the party seeking the constructive trust. See Cline v. Cline, 297 N.C. 336, 343, 255 S.E.2d 399, 404 (1979); Wilson v. Crab Orchard Development Co., 276 N.C. 198, 211, 171 S.E.2d 873, 882 (1976). These broad equitable principles provide Safeco with a strong basis for asserting that the funds in the certificate of deposit are subject to a constructive trust to the extent that Magna removed the funds from account number 1625 in order to deprive Safeco of the funds. If, as probably can be established by Safeco, account number 1625 was a trust account and the funds thus were being held in trust for Safeco, it is a very easy step to say that Magna acquired the funds through a breach of duty and that such taking of the funds constituted misconduct sufficient for the court to exercise its equitable powers to order restitution or restoration of the funds by means of a constructive trust. In short, it appears that Safeco is in a position to make a strong case for equitable relief. In reaching this conclusion, the court has considered the argument by Fireman's Fund that Safeco does not have clean hands and may not invoke equitable relief. This argument has been rejected because, after the extensive discovery that has been conducted in the contested matter, Fireman's Fund has not been able to point to any credible evidence that would raise that issue at trial.

Having reviewed the record in this case and compared the likelihood of success by the Trustee to the benefit offered by the settlement, the court is convinced that such a comparison weighs in favor of approving the settlement. The court reaches this decision fully cognizant of the fact that the amount which the Trustee would retain if successful is \$2,226,074.12 plus accruing interest, while the amount he will receive under the settlement is \$500,000.00. However, given the weaknesses inherent in the Trustee's position and the significantly greater likelihood that Safeco would prevail at trial, which would result in the Trustee receiving nothing, the factor involving probable outcome weighs in favor of approving the proposed settlement.

Other factors which are relevant in evaluating the proposed settlement likewise weigh in favor of approving the settlement. If the settlement is not approved and the Trustee has to litigate the contested factual issues and legal complex issues involved in the contested matter, the Trustee and the estate will be faced with significant expense and long delay before any funds will be available should the Trustee ultimately prevail. Even though discovery has been completed and the contested matter is essentially ready to be scheduled for trial, it is clear that a trial in the bankruptcy court in which the Trustee prevailed would not end this controversy. Given the amount of money at stake and the resources of Safeco, it seems certain that if the Trustee were successful in



a trial in the bankruptcy court, he then would be faced with one, possibly two appeals before finality could be achieved and funds made available for distribution in this case. These are daunting circumstances for a Chapter 7 trustee in a case in which the bankruptcy estate is virtually penniless. Also weighing in favor of approving the settlement is the experience and ability of counsel for the Trustee who has exhibited a strong grasp of the legal and factual issues facing the Trustee and who has the ability and experience to realistically evaluate the strengths and weaknesses of her case. Also, the Trustee's attorney has first hand knowledge of the witnesses who would need to be called at a trial and hence is in a better position than the court to evaluate the strength and credibility of such witnesses. Finally, the court is satisfied that the settlement is the product of arms length negotiations and bargaining. The settlement was reached in the context of a court-ordered mediation following extensive, good faith negotiations.

The views and contentions of Fireman's Fund in opposition to approval of the settlement are entitled to and have been given careful consideration. Fireman's Fund through its counsel has been involved actively in the contested matter from the outset and has actively participated in contesting the Safeco claim. However, the objection of Fireman Fund is based upon a misconception of the standard involved in the court's decision whether to approve the proposed settlement and an overly optimistic assessment of the

strength of the Trustee's position in this matter. Contrary to Fireman's Fund's argument, approval of the settlement does not depend upon whether Safeco has established a trust. This argument must be rejected because, as noted above, it is not appropriate for a court considering a settlement to convert the proceeding into a trial on the merits. "Otherwise, there would be no point in compromising; the parties might as well go ahead and try the case." See COLLIER ON BANKRUPTCY ¶ 9019.02, p. 9019-5 (15th ed. rev. 2003). Nor can the court accept the argument by Fireman's Fund that the amount of the settlement is speculative or the argument that the due process rights of creditors have been violated by the Trustee. The record includes an affidavit setting forth the exact value of the certificate as of the day of the hearing and a description of the manner in which interest is computed. The court is satisfied that neither the amount of the certificate of deposit nor the amount of the proposed settlement is in any way speculative. Nor does the settlement violate the due process rights of creditors in the Magna case. The Trustee filed an application for approval of the settlement together with a supporting memorandum. A hearing on the application was scheduled for July 17, 2003. Creditors and other parties in interest were served by mail with a notice of hearing on June 19, 2003. The Trustee's application and supporting memorandum set forth in considerable detail the Trustee's reasons for seeking approval of the settlement and was a part of a well-developed record

concerning the evidence and legal issues in the contested matter. Fireman's Fund and other creditors and parties in interest were afforded adequate notice and an opportunity for hearing regarding the proposed settlement and, in fact, Fireman's Fund was permitted to supplement the record with additional evidence and a memorandum in opposition to the settlement following the hearing. Under these and the other circumstances of this case, the court is satisfied that there has been full compliance with Rule 9019(a) and that approval of the proposed settlement will not violate the due process rights of any creditor or other party in interest in this case.

In conclusion, after reviewing the settlement and considering the foregoing factors, together with the arguments in support of and in opposition to the proposed settlement, the court finds and concludes that the settlement is fair and reasonable and in the best interest of the estate and, therefore, should be approved. An order so providing will be entered contemporaneously with the filing of this memorandum opinion.

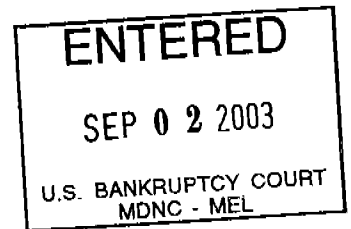
This 29th day of August, 2003.

**William L. Stocks**

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WILLIAM L. STOCKS  
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF NORTH CAROLINA  
DURHAM DIVISION



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	)	
William L. Yaeger, Trustee	)	
for Magna Corporation, and	)	
Fireman's Fund Insurance	)	
Company,	)	
	)	
Respondents.	)	

ORDER

In accordance with the memorandum opinion filed contemporaneously herewith, it is ORDERED, ADJUDGED AND DECREED as follows:

(1) the motion by William L. Yaeger, the Chapter 7 Trustee in this case, for approval of the proposed settlement with Safeco Insurance Company and Insurance Company of America is GRANTED and the settlement described in the motion is hereby approved; and

(2) the division of the proceeds of certificate of deposit number 895155758 provided for under the settlement pursuant to which the Trustee is to receive \$500,000.00 and Safeco Insurance Company and Insurance Company of America are to receive the balance of the proceeds is hereby approved and authorized.

This 29 day of August, 2003.

**William L. Stocks**

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WILLIAM L. STOCKS  
United States Bankruptcy Judge